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Next 1 Page(s) In Document Denied

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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #41
20 June 1985

Summary

The Cartagena Group plans to hold a technical meeting by early July in Montevideo and possibly a ministerial meeting by August in a city to be determined. Uruguayan Foreign Minister Iglesias, the group's Secretary Pro Tem, stated that the two meetings will evaluate the work accomplished and define a complete program for future actions. Meanwhile, recent public and private statements by several Latin leaders have raised the possibility of a meeting among Latin Chiefs of State to discuss their external debt problem. In a separate issue, several key LDCs recorded a drop in exports during the first quarter of 1985. Other developments in recent weeks include:

- o The Mexican government is beginning to pull back from its pre-election stimulation of the economy. Even if fully implemented, however, recent measures will not be enough to enable Mexico to meet IMF targets.

- o Brazil and the IMF concluded three weeks of talks last weekend without reaching agreement on a letter of intent for a new IMF standby arrangement. Tentative agreement on 1985 inflation and monetary expansion targets may have been reached, but the two sides are far apart on the public sector deficit target and other issues.

- o Argentina has moved with unaccustomed swiftness to attempt to comply with the new IMF-supported stabilization program targets that were established on 11 June. Measures announced by President Alfonsin included a devaluation and redenomination of the peso, public service and energy price hikes, and wage and price freezes.

- o Chile has made progress toward an eventual rescheduling of some of its official debt and gaining a co-financing agreement with the World Bank. Despite these favorable developments, we estimate that Santiago will need $100 million more in new lending from banks than previously anticipated.

- o On 30 May, the IMF Executive Board approved a set of revised targets for the Philippine standby arrangement which, if met, would enable Manila to draw its second tranche of funds originally scheduled to be released last April. Most of the revised end-May targets have been met, clearing the way for the $107 million disbursement later this month or in early July. 25X1

NOTE: THE NEXT REPORT WILL BE PUBLISHED ON 18 JULY 1985

This situation report was prepared by analysts of the Intelligence Directorate. Comments are welcome and may be addressed to the Situation Report Coordinator, 25X1

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UPCOMING IMPORTANT DATES

Date	Event/Country	Comment	
19-23 June	Latin American Parliamentary Conference (Brasilia)	Discussions will include the debt problem. Cuba is reportedly interested in obtaining full membership in the LAP. [redacted]	25X1
24 June	Paris Club (Togo)	Tentatively scheduled meeting to discuss a rescheduling of debt owed to official bilateral creditors. [redacted]	25X1
25-26 June	Paris Club (Ivory Coast)	Tentatively scheduled meeting to discuss a rescheduling of debt owed to official bilateral creditors. [redacted]	25X1
Early July	Cartagena Group Technical Meetings (Montevideo)	Uruguayan Finance Minister Iglesias is planning a technical meeting to be held by early July. [redacted]	25X1
15-17 July	Latin American Trade Union Conference (Havana)	This conference will deal exclusively with the foreign debt problem. [redacted]	25X1
15-19 July	Paris Club	Tentatively scheduled meeting to discuss debt rescheduling for Morocco, Jamaica, and possibly Cuba, Poland, Chile, and Panama. [redacted]	25X1
28 July	Presidential Inauguration of Alan Garcia (Peru)	Visiting Heads of State and Foreign Ministers may hold informal private discussions on debt. [redacted]	25X1
12-14 August	Labor Congress Meeting (La Paz)	Bolivian Labor Confederation will sponsor a conference on Latin American debt and invite labor organizations from around the world. [redacted]	25X1
August	Cartagena Group Ministerial Meeting	Meeting may be set up after the inaugurations of the governments of Peru and Bolivia at a yet-to-be-determined location. [redacted]	25X1

[redacted] 25X1

 [redacted] 25X1

KEY ISSUE

Latin American Debt Talks

The Cartagena Group plans to hold a technical meeting by early July in Montevideo and possibly a ministerial meeting by August in a city to be determined, according to press reporting. Uruguayan Foreign Minister Iglesias, the group's Secretary Pro Tem, stated that the two meetings will evaluate the work accomplished and define a complete program for future actions. In recent press conferences, Iglesias has warned that Latin American nations could assume positions of force to deal with debt payments if their situation worsens. Meanwhile, recent public and private statements by several Latin leaders have raised the possibility of a meeting among Latin Chiefs of State to discuss their external debt problem. [redacted] 25X1

[redacted] 25X1

Meanwhile, Cuba's Fidel Castro is exploiting the debt issue, giving numerous speeches and interviews to strengthen his ties with Latin America, according to Embassy and press reporting. Castro has urged developing countries to demonstrate their firmness and stage a general strike of debtors. The Cuban leader recently spoke on debt at the closing session of a Latin America women's group meeting and is expected to repeat his performance before the July hemispheric Trade Union Conference. [redacted] 25X1

[redacted] 25X1

DEVELOPMENTS IN MAJOR COUNTRIES

Mexico

The Mexican government is beginning to pull back from its pre-election stimulation of the economy. Recently implemented measures include additional budget cuts, reduced foreign exchange restrictions, and smaller than expected midyear wage hikes. Even if fully implemented, however, these actions are not enough to enable Mexico to meet IMF targets. Moreover, trends in the external accounts suggest that Mexico this year may incur its first current account deficit in three years. The soft oil market has pushed oil exports this month below 1 million b/d — over a one-third reduction from last June. We believe that lower export volume, combined with the announced price reductions in January and June, have cost Mexico an estimated $1 billion during the first half of 1985. At the same time, the overvaluation of the peso has cut nonoil exports by over 16 percent and encouraged imports, which rose some 39 percent, in the first quarter of this year compared with the same period in 1984. We expect capital flight to continue at about $500 million per month until the government reduces inflationary pressures and realigns the exchange rate. [redacted] 25X1

[redacted] 25X1

[redacted]

[redacted] 25X1

[redacted] As long as Mexico City is willing to draw on its foreign reserve cushion of about $6 billion and oil earnings do not fall from current projected levels, the de la Madrid administration can avoid seeking large new commercial loans. Meanwhile, recent reductions in world interest rates and the resulting reduction in debt service have caused the Finance Ministry to put on hold a proposal to ask commercial creditors to hold debt repayments to a fixed percentage of export receipts, [redacted] 25X1 25X1

Brazil

Brazil and the IMF concluded three weeks of talks last weekend without reaching agreement on a letter of intent for a new IMF standby arrangement. The press reports that the two sides may have tentatively agreed on 1985 inflation and monetary expansion targets but remain far apart on the size of reduction in Brazil's public sector deficit and on other issues. A date for resuming the negotiations has not yet been set. [redacted] 25X1

[redacted] 25X1

Argentina

Buenos Aires has moved with unaccustomed swiftness to attempt to comply with the new IMF-supported stabilization program targets that were established on 11 June. Steps to date include an 15.2-percent devaluation of the peso, public service and energy price hikes, wage and price freezes, and immediate redenomination of the currency. [redacted] 25X1 25X1

A premature leaking of the details of the government's "shock" economic program, which caused a run on domestic banks, has undermined the Alfonsin administration's ability to implement its program smoothly and with minimum disturbance to financial markets, according to the US Embassy. Moreover, the impact of the devaluation as an incentive to farmers to increase production was largely neutralized by the immediate imposition of higher export taxes on agricultural products, according to Embassy reporting. [redacted] 25X1

The actions, nevertheless, show a serious Argentine commitment to the revived IMF-supported program. The flexibility built into the new inflation and nominal peso monetary targets should improve Buenos Aires' prospects for compliance compared to the previous IMF program. The initial reactions from labor and most opposition parties have been negative, but the business sector has generally supported the government's actions. Labor leaders and Peronists have called for radical actions on the foreign debt, but their views probably will find little support in the government. Nonetheless, if the economy is

[redacted] 25X1

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[redacted]

in a tailspin as the November congressional elections approach, we believe Alfonsin could substantially soften his commitment to austerity. [redacted] 25X1

REGIONAL SITUATIONS

Latin America

Among other Latin American nations, Chile has made progress on rescheduling some of its official debt, Peru's loan classification was maintained at substandard by US regulators, Colombia reached tentative agreement with its bank advisory committee on a $1 billion loan, and some creditors may soon attach Bolivian assets. [redacted] 25X1

Chile

Chile has made progress toward an eventual rescheduling of some of its official debt and gaining a co-financing agreement with the World Bank. Santiago appears willing to accept a rescheduling of $170-190 million in official credits and guarantees coming due between July 1985 and the end of 1986, according to Embassy reporting. The Paris Club may meet in July to reschedule some of Chile's official debt. The World Bank also has given preliminary approval to guaranteeing half of a $300 million commercial bank project loan package. Despite these favorable developments, we estimate that Santiago will need $100 million more in new lending from banks than previously discussed. The Pinochet regime recently lifted the 7-month-old state of siege, gaining creditor country support for a World Bank loan approved on 18 June. Bankers have been delaying negotiations until Chile receives stronger international support in the multilateral development banks. A Chilean governemnt guarantee of private financial debt will be necessary to reach agreement with commercial banks on rescheduling of 1985-87 principal repayments. Any action by Santiago in response to its increasing financial strains — such as establishing exchange controls or imposing a debt service moratorium — would unravel the whole debt package, according to Embassy reporting. [redacted] 25X1

Peru

According to press reporting, Peru's Finance Minister Garrido Lecca said that the country's loan rating was maintained at substandard by US bank regulators. [redacted] 25X1
[redacted] a downgrading of Peruvian loans to value-impaired was expected by 25X1
many in the financial community. Garrido Lecca stated that the substandard rating would be reviewed again in September. Peru's interest arrearages to commercial banks totaled $213 million in early June. We believe that the absence of a downgrading by US regulators may serve as an incentive for President-elect Alan Garcia to negotiate an IMF-supported agreement and eliminate arrearages with commercial banks. [redacted] 25X1

Colombia

Colombia and its bank advisory committee recently reached partial agreement on a $1 billion loan. The terms include an interest rate of 1.75 percentage points above LIBOR, or 1.375 above the US prime rate, and a 3-year grace period. [redacted] 25X1
[redacted] the loan proposal will be sent in late June to all bank creditors for approval, and 25X1
formal signing could occur in the fourth quarter of 1985. Many US regional banks are favorably disposed to Colombia's request for new money, [redacted] 25X1
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[redacted]

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[redacted] 25X1

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__Jamaica__

The IMF Managing Director approved Kingston's letter of intent last month after arduous negotiations, but Jamaica's foreign exchange shortage could complicate final approval by the Executive Board of the new $120 million standby arrangement. According to Embassy reporting, over $30 million in IMF repayments will fall due on 1 July, but Fund officials are uncertain whether Kingston will be able to meet this obligation. If Jamaica falls into arrears to the IMF, approval of the new standby would be withheld until arrearages were eliminated. Meanwhile, Jamaica's request for a Paris Club rescheduling also might enounter problems because of the failure to make payments due under its July 1984 rescheduling agreement to France, Japan, and the United Kingdom, according to Embassy reporting. Until all amounts due under last year's rescheduling are paid, the Paris Club, probably would not consider a further agreement. [redacted] 25X1

__Cuba__

At meetings of the Paris Club's Cuban Task Force, Cuba's official creditors reached agreement on 1985 economic performance targets, paving the way for a rescheduling of 1985 principal repayments, according to Embassy reporting. Although the targets are generous — particularly considering that Havana failed to meet six of nine targets last year — we anticipate that Cuba will have difficulty meeting several of

[redacted] 25X1

its new targets. Specifically, we believe Havana will fall far short on increasing non-sugar hard currency exports by the agreed 44 percent this year. The short-term outlook for hard currency nickel and citrus earnings is bleak, and stagnating Soviet oil deliveries combined with Cuba's growing domestic energy demand will limit earnings from fuel reexports. Disappointing earnings plus an anticipated 11-percent increase in Western imports probably will push the hard currency current account deficit this year far above the $48 million approved by the Task Force creditors. As a result, the agreement may be reexamined, either later this summer when repayment terms are negotiated or during a formal review proposed for October. [redacted] 25X1

Eastern Europe

In Eastern Europe, Yugoslavia and its bank creditors remain at an impasse on rescheduling talks, and Poland may sign the Paris Club agreement covering 1982-84 obligations in early July. [redacted] 25X1

Yugoslavia

No progress was made in resolving the impasse between Yugoslavia and its bank creditors on rescheduling terms during a 22 May meeting in Belgrade, [redacted] 25X1 25X1 Maintaining a hard line, the Yugoslavs refused to accept IMF monitoring over the full life of the rescheduling, protested that the interest rate proposed by the banks was too high, and demanded that the terms for Yugoslavia be in line with those granted to Mexico last year. [redacted] 25X1

The Yugoslavs and the chairman of the banks International Coordinating Committee (ICC) are scheduled to meet on 2 July to clarify the IMF's monitoring role and to find a basis for another negotiating session with the full ICC. [redacted] 25X1 25X1 Yugoslavia faces some time constraints. The current payment standstill period ends on 30 June, and Yugoslavia may draw on the next tranche of its IMF standby only if it has reached agreement with its bank creditors by 29 August 1985. [redacted] 25X1

Although Yugoslavia's external position has showed some improvement since January, the first quarter ended with a hard currency current account deficit of $222 million, a sharp contrast to the $42 million surplus in the first quarter of 1984. The hard currency trade deficit for the first quarter reached $376 million, up from $140 million in the same period of 1984. Through the first four months of this year, hard currency exports have fallen 5 percent from last year's level, while imports have risen 11 percent. [redacted] 25X1

Poland

According to press reports, Polish Foreign Minister Olszowski announced that Poland is ready to sign the rescheduling agreement with the Paris Club covering 1982-84 obligations. Olszowski indicated the signing will take place during the week of 1 July, although the Paris Club has not yet set a firm date for its next meeting with the Poles. Warsaw had delayed signature on grounds that it could not live up to the terms of the agreement without assurances of new credits. The Poles, however, have not yet received any firm commitment. France, West Germany, and Switzerland have indicated they would extend small amounts of credit only after conclusion of a 1985 rescheduling agreement. Warsaw may have decided to go ahead with signing the 1982-84 agreement in hopes that it will have more success in obtaining credit commitments in bilateral

[redacted]

negotiations with Western governments. At the May Paris Club meeting, the creditors told the Poles that they would discuss other solutions at a future date if Warsaw cannot meet payments due under the rescheduling agreement. [redacted] 25X1

Asia

Among Asian countries, the IMF approved a set of revised targets for the Philippine standby arrangement, and Thailand obtained $585 million in credits from the IMF. [redacted] 25X1

Philippines

On 30 May, the IMF Executive Board approved a set of revised targets for the Philippine standby arrangement which, if met, will enable Manila to draw its second tranche of funds originally scheduled to be released last April. [redacted] 25X1 25X1

[redacted] According to Philippine press reports, most of the revised end-May targets have been met, clearing the way for the $107 million disbursement later this month or in early July. [redacted] 25X1 25X1

Thailand

The IMF approved a $585 million balance-of-payments assistance package for Thailand earlier this week. [redacted] the package includes a $400 million standby arrangement to be drawn in $50 million installments through March 1987. In addition, $185 million in compensatory financing will be available immediately. The Thai adjustment program will include measures to tighten monetary policy and to reduce the central government deficit in order to reduce the current account deficit from 5 percent of GDP last year to 4 percent in 1985 and 3 percent in 1986. [redacted] 25X1 25X1

Africa/Middle East

In Africa, Egypt's external deficit for this fiscal year will exceed its earlier projection, and Zaire reached agreement with the Paris Club pending a return to compliance with its IMF program. [redacted] 25X1

Egypt

Egypt's external deficit for the fiscal year ending this month likely will exceed its earlier projection of $375 million, a reversal of last year's $162 million surplus, according to Embassy reporting. An IMF team that recently returned from Egypt reports that the financial gap for the 1985-86 fiscal year can only be closed with substantially increased aid or debt rescheduling. Egypt's principal foreign exchange earners — oil sales, worker remittances, and Suez Canal revenues — are stagnating or falling. Moreover, the Fund staff believes that recent actions by Cairo to relax foreign exchange controls and increase bread and energy prices have done little to stem the flow of red ink and that a more comprehensive program is required. [redacted] 25X1

[redacted] 25X1

 [redacted] 25X1

Egypt has approached the Fund for a standby credit but reaching an agreement will prove difficult and time consuming. This will be complicated by the lack of timely and complete financial data. An IMF-sponsored adjustment program probably would focus on raising prices and interest rates, cutting the government's budget, and further reforming the foreign exchange system. The government, however, would not accept any program that comes down too hard on the populace or gives the appearance of "caving in" to the IMF. [redacted] 25X1

Zaire

Zaire reached agreement with the Paris Club in late May on a rescheduling of about $520 million in debt service, but formal signatures were withheld pending Zaire's return to compliance with its IMF-supported program. According to Embassy reporting, the agreement reschedules 95 percent of principal and interest falling due between 1 January 1985 and 31 March 1986 over ten years, including five years of grace. IMF officials believe that with strong effort Kinshasa can meet its 30 June economic targets, allowing Zaire to make a $23 million Fund drawing — stalled by violation of March targets — and clearing the way for implementation of the Paris Club agreement. [redacted] 25X1

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Appendix

Selected Key LDC Exports

Several key LDCs recorded a drop in exports in the first quarter of this year, compared to the same period in 1984, with Brazil and Mexico suffering the largest declines. In Brazil, manufactures exports were down 10 percent and commodity exports fell 7 percent, the result of slowing OECD economic growth and loss of export financing. Mexican exports suffered from an unfavorable international oil situation, a sharp slowdown in the US economy, and continued real appreciation of the peso; both oil and nonoil exports showed declines. 25X1

(Million US $)

	1984(1st Qtr)	1985(1st Qtr)	% Change
Argentina[1]	656	618	-6
Brazil	5634	5073	-10
Mexico	6394	5691	-11
Philippines	1270	1150	-9

[1] Data for the month of January only.

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